

LOCATING THE ORIGIN AND ROLE OF ENTREPRENEUR IN ECONOMIC THEORIES

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ABSTRACT

The complexity and ubiquitous nature of entrepreneurship field compelled it to evolve as a multidisciplinary subject area. Various academic fields have contributed at philosophical, conceptual and methodological levels to highlight the different facets of entrepreneurship. One has to get hold of any one side of the string to generate the basic understanding of “entrepreneurship” (phenomenon) and the “entrepreneur” (individual initiating the process) by reviewing the extant literature on the subject. The subject roots are in economics discipline but the treatment it received therein added further to its complexity, hence, no unanimous definition of entrepreneurship could be reached at. The paper therefore, aims to explicate the economic theories to offer a workable definition that can provide a fresh start to early academics in the discipline.

INTRODUCTION

An investigation into the phenomenon and the subject of entrepreneurship suggests that it is the relationship between the subject and his/her actions situated in specific contexts. The contributions of different academic fields to entrepreneurship literature have resulted in the

diversity of views but have enabled highlighting the diverse aspects of entrepreneurship from the lens of different academic disciplines. For some, entrepreneurship is an economic activity carried out to contribute to economic growth, for others it a phenomenon occurring in special social settings and benefiting the society at large. Others see entrepreneurship as being synonymous with the creation of something new or innovative and these innovative activities as the outcome of insights and capabilities of the individual entrepreneur. Bygrave (1989) argues that the unending debate on definition of entrepreneurship and the resulting inconsistency is rooted in the entrepreneurship researchers' implicit desire to achieve "mathematical precision". He labels these trends as 'physics' envy and suggests that entrepreneurship should benefit from inductive studies.

Landstrom (2005) views a threefold division in entrepreneurship literature; individual entrepreneur, the market function aspect or the interaction of both as a dynamically evolving process. These three perspectives correspond to three main research questions, that is, 'what', 'why' and 'how' of entrepreneurship as a field of research (Stevenson and Jarillo, 2007). 'What' question is concerned with results of entrepreneurial acts and focuses on new value creation, for instance, "what happens when entrepreneurs act?" It allows entrepreneurship to be seen as a function of the market and the entrepreneur as an economic agent. It helps to analyse the role entrepreneurs play in the economic development and growth. 'Why' questions focus on individual entrepreneur and the causes of entrepreneurial actions, such as, entrepreneur's background, motivations and value system. Whereas, the 'how' question centres on the characteristics of entrepreneurs and factors affecting the entrepreneurial process. Research

studies on ‘what’ and ‘why’ of entrepreneurship are one-dimensional because they focus on either the entrepreneur as an economic agent, or the market process to which entrepreneur contributes. Whereas, studies investigating the ‘how’ of entrepreneurship, characterized as process studies, are multidimensional in scope. The latter takes the entrepreneur as the central actor together with his/her response to the dynamic, surrounding environment and conceives their dynamic relationship.

The apparent dichotomy of the research studies between content research (answering what and why questions) and process research (investigating ‘how’) can be useful in locating the phenomenon and the subject in various existing discipline of economic literature on entrepreneurship. Identification of these approaches help in appreciating the strengths they add to the field and identify the possible research gaps to carry out future research. In locating entrepreneurship within existing disciplines, the boundaries and sometimes the limitations confining the subject to these disciplines can be identified.

HISTORICAL PERSPECTIVE OF CONTRIBUTIONS OF ECONOMISTS TO THE FIELD OF ENTREPRENEURSHIP

1. Etymology

The word “entrepreneur” originating from the French verb “entreprendre” means “to undertake” (Carland, Hoy and Carland, 1988; Landström, 2005). “Entre” comes from the Latin word meaning “between”, and “prendre” means “to take” (Swedberg, 2000). In English language the entrepreneur is defined as an adventurer or a person who deliberately accepts the chance of

loss in search of profit (Landström, 2005). Another explanation of the origin of the word entrepreneur is the German verb "unternehmen" that means "to undertake" (Cunningham and Lischeron, 1991). The concept of entrepreneurship is as ancient as human kind but as a distinct academic discipline it is still in the infancy.

2. The 'Entrepreneur' in Economic Theories

The concept of entrepreneurship emerged from the economics discipline. It is conceptualised as a market function and the entrepreneur is considered to be an agent of economic change (Swedberg, 2000). This review makes a critical evaluation of entrepreneurship within various schools of economics with reference to the contributions of well-known economists. The economic approach views entrepreneurship to be initiated by an individual who is motivated by special circumstances and is ready to take risk.

a. Entrepreneur(ship) in Classical Economics

The era of classical economics is generally considered to be initiated by Adam Smith in 1776. The main proponents of classical economics include Adam Smith (1723-1790), Jean Baptiste Say (1767-1833), Von Thunen (1785-1850) and Von Mangoldt (1824-68), David Ricardo (1772 –1823), John Stuart Mill (1806 –1873) and Thomas Malthus (1766 –1834). The entrepreneur remained 'invisible' within the strict assumptions of classical economics. Primarily concerned with macroeconomic view, it postulated theories of price and value. Classical theory

is based on assumptions of perfect information, competition and homogenous products. It reflects the trends of 18th and 19th century when there was a shift from feudal system to industrialism. The class based interest from rulers' personal gain was shifted to the capitalism with the basic assumption that income should go to the factors of production in the form of interest, rent and wages (Van Praag, 1999). The recognition to organize the factors of production and identification of best decision making ability necessitated the shift of focus to the role of entrepreneur. Classical economists assumed that investment, production and capital are the automatic processes hence, role of entrepreneur, the decision making entity, vanished. Classical theory had no space for the entrepreneur as the principal agent of economic change (Swedberg, 2000). The capitalist and the entrepreneur were considered as the same. A possible reason for this amalgamation of capitalist and entrepreneur could be a merger of roles in economies. Small and medium enterprises (SMEs) were mostly family firms (privately funded), with friends and family as fund providers and therefore only capital holders could become entrepreneurs. Adam Smith (1776) and other English economists (e.g., David Ricardo) also amalgamated the entrepreneurial practice and ownership of capital (provider of stock of enterprise). Smith considered formation of organizations in reaction to economic changes done by individuals who are termed as "enterprisers" (Van Praag, 1999).

In the same era, a French economist, Cantillon (1776), observed that discrepancies in market supply and demand create opportunities to buy cheap (at certain prices) and sell dear (at uncertain prices). The entrepreneur was posed as an arbitrageur who speculates but does not alter the demand and supply forces of the market but only takes advantage of unrealized profit

opportunities. Therefore, entrepreneurship is a matter of foresight and risk taking. Cantillon's compatriots Francois Quesnay (1694-1774), Nicolas Baudeau (1730-1792), and Anne-Robert Jacques Turgot (1727-1781), followed his thought of entrepreneur as an arbitrageur. Quesnay added the concept of innovation in economic analysis of entrepreneur by noting that introduction of new product, method of production requires bearing uncertainty along with organization and supervision of production functions (Formaini, 2001; Jackson, Gaulden and Gaster, 2001).

Following the capitalist-entrepreneur debate, Say (1767-1832) distinguished between the functions of capital provision and superintendence, control, direction and judgment by referring to the concept of entrepreneur presented by Cantillon (Hébert and Link, 2009). However, he considered production and investment more or less automatic, hence, undermining the role of entrepreneur in the economy. For John Stuart Mill (1848), a British economist, the notion of entrepreneur entails the concept of risk, unique combination of productive factors and "superintendence". He argued that profit is not only a reward for combining factors of production but also for risk taking (Formaini, 2001). However, Carl Marx considered business process to be virtually automatic and decision maker is "capital personified". His entrepreneur is the residual claimant of the earnings from the production process. Carl Marx's view of entrepreneur is static as it ignores the market dynamism causing uncertain conditions for decision making that lead to the risk taking by entrepreneurs. Johann Van Thunen (1785-1850) accounted for risk taking behaviour of the entrepreneur by considering him the claimant of risky earnings in unpredictable environment (Gopakumar, 1995). In Walras's (1834-1910) economic

theory the entrepreneur disappears because he attributes least importance to human behaviour and a high weightage to the market dynamics (Barreto, 1989).

b. Take of Neoclassical Economists on Entrepreneur(ship)

The philosophy of self equilibrating market forces, underpinning the classical school of thought, restricts the role of entrepreneur to a coordinator of resources, or/and an arbitrageur but negates the innovation aspects. The assumption of rational choice hypothesizes the availability of perfect information (characteristic of perfect competition) to all economic actors and presupposition that future events can be predicted and measures can be taken against contingencies. Therefore, the entrepreneur remained more or less a capitalist, who invests into business and manages the resources (owner-manager), in classical economic thought. Neo classical school extends the thought of market equilibrium by incorporating the concept of uncertainty and risk, and considers profit as the reward for taking risk. Frank Knight's (1921) entrepreneur is the bearer of uncertainty. Knight (ibid) extended on Cantillon's concept of risk and uncertainty and elaborated on Thunen's distinction between risk and uncertainty. In his book, 'Risk, Uncertainty and Profit' (1921), he explains entrepreneurship in terms of risk (where objective probability can be calculated) and uncertainty (where nothing can be known). Risk can be calculated, insured and be made the cost of production on the basis of probability of measurement, but it is not a cause of the profit. Entrepreneurial ability relies on effectively dealing with uncertainty. The neo-classical economics recognizes entrepreneur as a risk taker. However, it does not address the critical 'human aspects', the entrepreneurial ability of managing risk and decision making. According to the Austrian school of economics entrepreneurship is

considered as a unique phenomenon because it studies the most fundamental unit of human behaviour- the human action. The praxeological focus allows a natural space to accommodate and elevate the role of the individual actors in the market place- entrepreneur being one of them. According to Landström (2005), Austrian school constitutes “the first swarm of entrepreneurship research” that was initiated by the theories of Carl Menger (supported by Bohm-Bawerk) in 1860 and carried forward by Mises and Hayek in the mid-twentieth century. The school is represented by Israel Kirzner, a thought leader in entrepreneurship.

Carl Menger’s (1871) argued that goods can be distinguished into orders where the highest order goods are used to produce the lower order goods; the lowest order goods are directly consumed. Thus, capital, land, labour and knowledge (high order) can produce machinery (middle order) which can produce consumable items (lowest order) from the raw material (middle order). The result of this hierarchy is that the higher goods are valued in terms of the lowest order goods (Foss and Ishikawa, 2007). For instance, the same set of factors of production can be employed to produce a variety of goods with different values. This conceptualization allows the individual to play the most critical role- the allocation of factors of production to the most valued production- and become an entrepreneur. It can be stated that “Menger... was very much concerned with the problems of uncertainty, imperfect knowledge, and the open-endedness of the world” (Langlois, 1985: 8). These are the essentially ontological ingredients that emphasize economics as relationships between humans (not objects) and the methodological subjectivism that recognizes and assigns core importance to the actions of individual (Landstrom, 2005). Menger’s subjectivist view of the economy is based on

differentiating between economic phenomenon and natural sciences and consideration of economic analysis through individual actions which perpetuates economic changes. In other words, entrepreneurs are agents of change, who transform resources into useful products and services in any economy. Carl Menger's entrepreneur is "not merely risk-bearer but a dynamic actor whose profits represent a reward for investing in risky ventures" (Brown, 2007: 18).

In the Austrian view, the entrepreneur is the one who transform the resources in the production chain and tackles the risk and uncertainty in this process (Brown, 2007). Mises (1881-1973) and Hayek (1899-1992) furthered Menger's conceptualizations. Mises argues that a successful entrepreneur correctly anticipates the market to exploit opportunities. For Hayek, the uniqueness of individual information allows for entrepreneurial actions. The contemporary thought leader on entrepreneurship, Israel Kirzner has focused his analysis on the interaction between individual entrepreneur and the environment. Kirzner's (1973) entrepreneurs are individuals who are alert to discover and exploit the opportunities. He defines "*alertness*" as a state of mind that aids in occurrence of spontaneous learning. Entrepreneurs are alert either by nature, or because the profit incentive is more important to them than to others (Gunning, 1997). The recognition of profitable opportunities is based on the hunch, but as soon as they are recognized, they become conscious knowledge from a subconscious activity and become a valuable resource for entrepreneur that aids in the decision making under uncertainty. Kirzner agrees with Mises that an entrepreneur's error becomes another entrepreneur's opportunity. He also draws on Hayek's (1990) work by relating entrepreneurship to knowledge about local conditions. In this sense, profit is the result of 'discovering new information' than the result of

analysis of already present information. He argues that discovering opportunities demand no special ability but exploiting them need creativity and leadership qualities. Kirzner's approach can be termed as psychological as it focuses on the qualities of individual entrepreneur. The Austrian School is indirectly responsible for 'nurturing' and allowing Schumpeter to progress the first complete theory of the entrepreneur (he was initially taught by Bohm-Bawerk).

c. Innovation as an Essential Component of Entrepreneurship

Schumpeter (1934) forwarded the most comprehensive theory of the entrepreneur. Whilst, Knight's entrepreneur is the bearer of uncertainty and gets rewarded for controlling and making judgment under prevalent uncertainty; Schumpeter's entrepreneur creates uncertainty through his creative destruction and makes his way in the competitive market. Entrepreneur is a decision maker who initiates change or innovation, adapt to that change and assume the consequences of uncertainty. Schumpeter's heroic entrepreneur is characterized as breakthrough innovator, motivated by the "dream and the will to found a private kingdom; guided by desire to conquer, the impulse to fight"(Goss, 2005: 208) and is strong to tackle the challenges of the external environment (Heertje, 1982). According to Schumpeter (1934) innovation is the core element of entrepreneurship. Schumpeter defined innovation as 'carrying out new combinations' that are;

1. 'The introduction of a new good'
2. 'The introduction of a new method of production'
3. 'The introduction of a new market'
4. 'The conquest of a new source of raw materials or half manufactured goods'

5. 'The carrying out of new organization of any industry'

Newness is captured in above definition as 'new combinations' but these new combinations in themselves do not engender innovation unless they are 'carried out' by an entrepreneur. It shows that the concept of 'newness/innovation' is incomplete without its 'practice'. In his book "The Theory of Economic Development" Schumpeter defines entrepreneurship as,

"Development (entrepreneurship) is then defined by carrying out of new combinations (of productive means or materials and forces)" (Schumpeter, 1934; 65-66)

For Schumpeter, 'carrying out' meant actual economic exploitation of innovation in the market. This definition clearly shows that unless new combinations are carried out they are not innovation but inventions. Schumpeter's definition of entrepreneurship is broad because it includes any new combination of already existing elements in the economy. Thus, innovation is not only technological but can include incremental changes. In other words, innovation does not always bring a "radical change" but it can cause "incremental changes". Baumol (1996) argues that entrepreneurs are available in all societies but their allocation to the productive sectors in the economy is the actual matter. Schumpeterian theory starts with an economy in equilibrium state, where people take decisions intuitively, on the basis of their long term experiences. There is no place for the entrepreneur in such an economy, who, in order to make profit, tries to destroy the existing order through innovation. The entrepreneur is a source of dynamic market changes inducing market disequilibrium through innovation, unlike neo-classical economists' concept of

disequilibrium by exogenous shocks. Thus, entrepreneur is the driver of economic growth and gives impetus to business cycles through his successes and failures (Goss, 2005).

Mark Casson (1982) synthesized the work of Schumpeter, Knight and Kirzner. An “entrepreneur is the person who specializes in taking judgmental decisions about coordination of scarce resources” (Aidis, Welter, Smallbone, & Isakova, 2007: 20) and possess the decision making ability. He takes different decisions in identical circumstances because he has different information or different interpretations of same information. Thus, entrepreneurship is a practice, packaged together with asset ownership because people are less likely to lend to a risky venture, therefore, personal wealth or wealth of relatives and friends is used by entrepreneurs. It appears to be the reason for merger of roles of capitalist and entrepreneur (decision making role), which is not an accidental phenomenon but the very nature of entrepreneurship.

CONCLUSION

The economic theories of the entrepreneur describe him as someone ‘who *takes risk* under *uncertainty* by being *alert* to the opportunities, which arise from the creative destruction, and earns economic *profit* by *coordinating the production systems innovatively*. Figure given below gives a snapshot of how entrepreneurship and entrepreneur are conceptualized in economic theories;

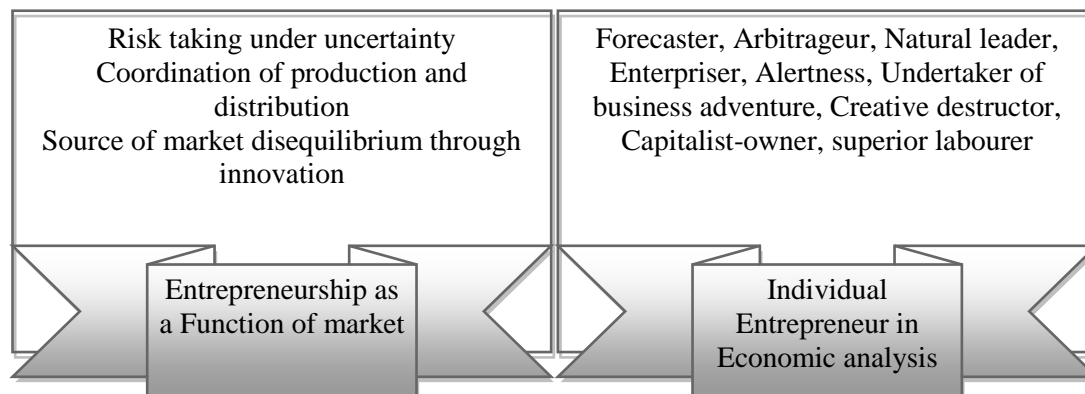


Figure: Entrepreneur (ship) in economic theories

A comprehensive sketch, drawn from review of economic literature of entrepreneurship, consists of evaluation of various external and internal forces shaping the process of entrepreneurship and affecting entrepreneur. In economic theories the status of entrepreneur is “controversial” because of the unrealistic assumptions. If orthodox classical and neo-classical economics did not assign any major role to the entrepreneur in economics process, the more unorthodox Knight, Schumpeter and the Austrian school of economics assigned a primary role to

the entrepreneur. Classical school emphasized the macroeconomic environment while the neo-classical stressed micro aspects of the economy. Austrian school focused human action as its basic unit of analysis. Schumpeter's landmark theory benefits from the liberal and unorthodox approach where he did not confine entrepreneur (ship) to strict boundaries of specific schools, yet he has a fleeting mention of the entrepreneur, providing it the authenticity it required for future elaboration. This theory benefits from the insights of previous economists and their incomplete but correct perspectives. Schumpeter provides a comprehensive list of motivations for the entrepreneur (mentioned in the previous section) which benefits from Von Thunen arguments (an entrepreneur is necessity driven) and Carl Menger's insights (entrepreneurship is an act of will). Schumpeter provided an elaborate description of innovation and related it to uncertainty bearing. The depiction of entrepreneurship thought as historical progression allows one to see the Schumpeterian theory of the entrepreneur as a watershed moment. Since its inception it has been reinterpreted in a variety of ways where the most important concern relates to entrepreneurship's potential in progressing and bringing economic growth.

The paper proposes to use Mark Casson's proposed definition of entrepreneur in economics discipline,) "*an entrepreneur is someone who specializes in taking judgmental decisions about the coordination of scarce resources*" (M. Casson, 1982) by adding value to it innovatively. Hence, we can say that entrepreneurship is the process of resources allocation and venture creation by the innovative, risk taker entrepreneur.

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